

Message Text

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ACTION EA-09

INFO OCT-01 ISO-00 ERDA-05 AID-05 CEA-01 CIAE-00
COME-00 DODE-00 EB-08 FPC-01 H-01 INR-07 INT-05
L-03 NSAE-00 NSC-05 OMB-01 PM-04 USIA-06 OES-06
SP-02 SS-15 STR-04 TRSE-00 ACDA-07 FEA-01 FRB-03
XMB-02 OPIC-03 LAB-04 SIL-01 IGA-02 IO-13 AGRE-00
PA-01 PRS-01 /127 W

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FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC 9929

C O N F I D E N T I A L SECTION 1 OF 2 JAKARTA 03574

E.O. 11652: GDS

TAGS: EAID, ENRG, ID

SUBJECT: WORLD BANK'S INDONESIAN REPORT

REFS: (A) JAKARTA A-36, (B) JAKARTA 3305, (C) STATE 59034

1. SUMMARY. IN OUR VIEW, IBRD BALANCE OF PAYMENTS PROJECTIONS, PARTICULARLY RE INDONESIA'S FUTURE IMPORT AND EXPORT PERFORMANCE, ARE OVERLY OPTIMISTIC. IN THIS MESSAGE, WE EXAMINE THE BOP EFFECT OF ASSUMPTIONS DIFFERENT FROM THOSE OF IBRD REGARDING FUTURE IMPORT EXPENDITURES AND OIL AND NON-OIL EXPORT REVENUES. WE ARE CONCERNED THAT FAVORABLE IBRD PROJECTIONS MAY LEAD TO GOI COMPLAISANCE WHICH WILL DELAY IMPLEMENTATION OF POLICIES NEEDED TO STIMULATE EXPORT INDUSTRIES AND CURB NON-ESSENTIAL IMPORTS. END SUMMARY.

2. IBRD REPORT ON INDONESIA INCLUDED ACTUAL BALANCE OF PAYMENTS STATISTICS FOR 1972/73 THROUGH 1975/76 AND PRELIMINARY FIGURES FOR 1976/1977. IN ADDITION, TEXT OF THE REPORT CONTAINS ESTIMATES WITH RESPECT TO THE VARIOUS COMPONENTS OF FUTURE BOP, WHICH MAKE IT POSSIBLE TO CONSTRUCT PROJECTIONS FOR 1977/78, 1980/81 AND 1984/85.

THE FOLLOWING TABLE PRESENTS THE IBRD ESTIMATE FOR 1976/77 AND OUR CONFIDENTIAL

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INTERPRETATION OF THEIR PROJECTIONS FOR 1977/78, 1980/81 -AND 1984/85.

IN READING TABLE, NOTE IBRD ASSUMES FOR PRESENTATIONAL PURPOSES THAT MISCELLANEOUS CAPITAL ACCOUNT WILL BE NEGLIGIBLE. HOWEVER, TO MAKE OUR CONSTRUCTED TABLES TALLY WITH THE IBRD'S PROJECTED RESERVE LEVEL INCREASES, WE HAVE ASSIGNED A BALANCING FIGURE TO THE MISCELLANEOUS CAPITAL ACCOUNT. (THE BOP STATISTICS USED HERE ARE TAKEN FROM THE

FINAL DRAFT OF REPORT. THERE ARE SOME SMALL DIFFERENCES IN THE FINAL REPORT BUT THE ANALYSIS IS ESSENTIALLY THE SAME AS IN THE FINAL REPORT.

NOTE THAT IBRD USES BOP STATISTICS IN SUMMARY TABLE AND STATISTICAL APPENDIX THAT ARE DIFFERENT THAN IN TEXT OF REPORT.)

BALANCE OF PAYMENTS IBRD REPORT
PRELIMINARY PROJECTIONS
(MILLIONS OF US DOLLARS)

YEAR	1976/77	1977/78	1980/81	1984/85
(EST.)				
EXPORTS	6,202	7,350	10,940	18,730
NET OIL (INC. LNG)	3,659	4,304	6,350	9,750
NON OIL	2,543	3,046	4,590	8,980
IMPORTS INC. NFS	(6,904)	(7,800)	(11,290)	(18,424)
TRADE GAP	(720	(450)	(350)	306
FACTOR PAYMENTS	(830)	(100	--	--
INVESTMENT INCOME	(447)	--	--	--
INTEREST	(353)	(100)	--	--
CURRENT A/C	(1,532)	(550)	(350)	306
DIRECT INVESTMENT	440	--	--	--
M PLUS L TERM	2,444	2,300	2,500	4,100
DISBURSEMENTS				
AMORTIZATION	(528)	(1,170	(1,870)	(3,000)
NET DISBURSEMENTS	1,916	1,130	630	1,040
MISC. CAPITAL ETC.	(169)	70	320	(746
MONETARY MOVEMENTS	(665)	(650)	(600)	(600)

(MINUS IS AN INCREASE IN RESERVES)

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FY YEAR END RESERVES	1,960	2,610	4,510	6,910
(EST.)				
DEBT SERVICE RATIO	14.2	15.9	17.1	16.3
(PERCENT)				

#NET TRANSFERS ON ACCOUNT OF DIRECT FOREIGN INVESTMENT ARE EXPECTED TO REMAIN CLOSE TO ZERO, FOR EXTENT OF ANALYSIS PERIOD (SEE PAGE 30 DRAFT).

3. THE IBRD ANALYSIS IS BASED ON A NUMBER OF ASSUMPTIONS. THE MOST CRITICAL OF THESE ASSUMPTIONS ARE:

(1) NET OIL AND GAS EXPORTS EARNINGS WILL INCREASE FROM \$3.66 BILLION IN 1976/77 TO \$6.35 BILLION IN 1980/81 AND \$9.75 BILLION IN 1984/85. THIS MEANS OIL PRICES ARE ASSUMED TO INCREASE BY 6 PERCENT AND THE VOLUME WILL INCREASE BY ABOUT 7 PERCENT PER YEAR.

(2) NON-OIL EXPORTS ARE ASSUMED TO INCREASE FROM \$2.54 BILLION

IN 1976/77 TO \$4.59 BILLION IN 1980/81 AND \$8.98 BILLION IN 1984/85.
THIS ASSUMES THAT PRICES WILL INCREASE BY MORE THAN 7 PERCENT PER
ANNUM UNTIL 1980/81 AND THEREAFTER SOMEWHAT MORE THAN 8 PERCENT
UNTIL 1984/85. THE VOLUME INCREASE WILL BE A LITTLE LESS THAN
2 PERCENT PER ANNUM UNTIL 1980/81 TO 1984/85.

(3) ACCORDING TO IBRD (FINAL DRAFT REPORT), IMPORTS ARE ASSUMED
TO GROW AT ABOUT 13 PERCENT PER YEAR IN CURRENT PRICES AND 5 PERCENT
IN CONSTANT PRICES.

(4) DISBURSEMENTS OF MEDIUM AND LONG TERM LOANS AND AMORTI-
ZATION ARE ESTIMATED ON BASIS OF DETAILED INFORMATION FROM BANK
INDONESIA AND EXCLUDES TANKER DEBT.

(5) MONETARY MOVEMENTS ARE LEVELS IBRD CONSIDERS PRUDENT, IN
RELATION TO IMPORT REQUIREMENTS.

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4. IN OUR VIEW, THE PICTURE PRESENTED BY THESE PROJECTIONS MAY BE
OVERLY OPTIMISTIC WITH RESPECT TO BOTH IMPORT AND EXPORT PER-
FORMANCE. THE IBRD ASSUMES THAT ANNUAL IMPORT GROWTH CAN BE HELD
TO 13 PERCENT, BUT WE NOTE RECENT STATISTICS WHICH SHOW THAT VALUE
OF IMPORTS INCREASED BY 73 PERCENT, 47 PERCENT, 18 PERCENT AND 27
PERCENT PER ANNUM FOR RESPECTIVE YEARS BETWEEN 1972/73 -ND 1976/77.
THIS INCLUDES PERIOD OF 1976 WHEN THE GOI TOOK SERIOUS STEPS TO
CONTROL ILLEGAL IMPORTS. NOTWITHSTANDING THE FACT THAT IMPORTANT
IMPORT-SUBSTITUTE INDUSTRIES (NOTABLY FERTILIZER AND CEMENT) ARE
EITHER ON-STREAM OR ABOUT TO COME ON-STREAM, AT CURRENT EXCHANGE RATE
WE ARE DOUBTFUL GOI CAN HOLD IMPORT GROWTH MUCH BELOW 18-20 PERCENT
RANGE. RE OIL EXPORTS, WE ESTIMATE (REFS A AND B) THAT OIL REVENUES
ARE LIKELY TO STABILIZE OR MAY EVEN DECLINE BECAUSE OF COMBINED
EFFECTS OF INCREASED DOMESTIC CONSUMPTION, SMALLER RESERVES THAN
PREVIOUSLY BELIEVED AND RECENT DECLINE IN EXPLORATORY DRILLING.
WITH REGARD TO NON-OIL EXPORTS, WE WOULD AGREE WITH BANK THAT FUTURE
WILL SEE SOME WELCOME DIVERSIFICATION IN INDONESIA'S EXPORTS, PAR-
TICULARLY WITH RESPECT TO LNG AND NICKEL AND POSSIBLE EVEN FERTILIZERS.

NEVERTHELESS, IMPORTANT EXPORTS WILL CONTINUE TO BE PRIMARY
COMMODITIES WHICH WILL REMAIN SUBJECT TO WIDE FLUCTUATION IN PRICES

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SP-02 SS-15 STR-04 TRSE-00 ACDA-07 FEA-01 FRB-03
XMB-02 OPIC-03 LAB-04 SIL-01 IGA-02 IO-13 AGRE-00
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AND DEPENDENT UPON CONTINUED ECONOMIC STRENGTH IN PRINCIPAL MARKETS. LONG LEAD-TIME AND HUGE INVESTMENTS WILL BE REQUIRED TO TAP NON-OIL MINERAL POTENTIAL, AND DECISIONS ON CERTAIN PROJECTS WILL HAVE TO BE TAKEN SOON IF THEY ARE TO AFFECT EXPORTS IN THE NEXT DECADE. WHILE PROGRESS IN THE MINING SECTOR IS EVIDENT, MUCH REMAINS TO BE DONE. POLICIES TO ACTIVELY ENCOURAGE PRIVATE INVESTMENT, BOTH FOREIGN AND DOMESTIC, AND TO PROMOTE THE COMPETITIVENESS OF EXISTING AND POTENTIAL

EXPORT AND IMPORT SUBSTITUTE INDUSTRIES ARE REQUIRED. ALTHOUGH THESE ISSUES ARE BEING ADDRESSED AT HIGH LEVELS IN GOI, AT THIS POINT, WE SEE FEW INDICATIONS THAT THE GOI IS MOVING FORWARD WITH THE PURPOSEFULNESS NEEDED TO ATTAIN THE KIND OF EXPORT PERFORMANCE ENVISIONED IN THE IBRD PROJECTIONS.

5. SINCE THE US MISSION'S NOTIONS ABOUT TRADE PATTERNS FOR THE FUTURE DIFFER FROM THE IBRD PRESENTATION, WE WILL BRIEFLY PRESENT THE ALTERNATE PICTURE THAT WILL RESULT IF WE MAKE SOME DIFFERENT ASSUMPTIONS ABOUT SOME OF THE TRADE STATISTICS. WE HAVE NOT ALTERED THE IBRD'S INVESTMENT AND AMORTIZATION ESTIMATES. WITH RESPECT TO THE AMORTIZATION ACCOUNT, HOWEVER, WE WOULD NOTE AGAIN THAT IT DOES NOT INCLUDE ANY PROVISION FOR TANKER LIABILITIES. IF THE REMAINING TANKER CONTRACTS ARE SETTLED ON THE SAME TERMS AS THE GOI
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RECENT AGREEMENTS, I.E., AT ABOUT 15 PERCENT OF VALUE PAID OVER A THREE-YEAR PERIOD, THIS WOULD INCREASE THE AMORTIZATION ACCOUNT BY ROUGHLY \$150 MILLION PER YEAR THROUGH 1980.

6. FIRST ALTERNATIVE: BASED ON REF A WE WILL SUBSTITUTE THE EMBASSY NET OIL REVENUE ESTIMATES (RATHER THAN REPEAT THE ENTIRE BOP TABLE WE WILL PRESENT ONLY THE KEY VARIABLES).

1977/78 1980/81 1984/85

NET OIL EXPORTS	4,430	5,400	5,130
(INC. LNG)			
TRADE GAP	(325)	(1,310)	(4,314)
CURRENT A/C	(425)	(1,300)	(4,314)
MONETARY MOVEMENT	(776)	350	3,408
(MINUS IS AN INCREASE IN RESERVES)			
FY YEAR END RESERVES	2,086	2,000	EST. #
DEBT SERVICE RATIO	16	19	22
(PERCENT)			

ADDITIONAL BORROWING WOULD BE REQUIRED TO MAINTAIN RESERVES

7. SECOND ALTERNATIVE: THE NON-OIL EXPORT PERFORMANCE SINCE 1972/73 HAS VARIED BETWEEN AN 8 PERCENT DECREASE BETWEEN 1974/75 AND 1975/76 AND A 35 PERCENT INCREASE FOR THE FOLLOWING YEAR. SINCE A REDUCTION IN NON-OIL REVENUES WOULD COMPOUND THE EFFECT OF THE SITUATION IN PARA 6, WE WILL NOT PRESENT ADDITIONAL PROJECTIONS OF GLOOM HERE. THIS SHOULD, HOWEVER, SERVE AS A REMINDER OF WHAT WILL HAPPEN IF INDONESIA'S NON-OIL EXPORT PERFORMANCE, FOR ANY OF A VARIETY OF REASONS, FAILS TO MEASURE UP TO RATHER OPTIMISTIC PROJECTIONS OF THE IBRD REPORT.

8. IN THE THIRD ALTERNATIVE WE WILL ASSUME THAT INDONESIA KEEPS IMPORT GROWTH AT A MORE LIKELY AVERAGE ANNUAL GROWTH RATE OF 20 PERCENT VS. THE IBRD ESTIMATE OF 13 PERCENT (SEE PARA 4). WE WILL ALSO USE THE IBRD OIL PROJECTIONS TO SEPARATE THE EFFECTS OF THIS ASSUMPTION FROM POSSIBLE SHORT-FALLS IN EXPORT PERFORMANCE.

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	1977/78	1980/81	1984/85
IMPORTS	(8,284)	(14,316)	(29,685)
TRADE GAP	(934)	(3,376)	(10,955)
CURRENT A/C	(1,034)	(3,366)	(10,955)
MONETARY MOVEMENT	(167)	2,410	10,049
(MINUS IS AN INCREASE IN RESERVES)			
FY YEAR END RESERVES	2,127	#	#
DEBT SERVICE RATIO	16	NA	NA
(PERCENT)			

ADDITIONAL BORROWING REQUIRED TO MAINTAIN RESERVES.
DEBT SERVICE RATIO DEPENDS ON TERMS OF BORROWING.

9. COMMENT: THE FOREGOING IS NOT INTENDED AS A PREDICTION OF FINANCIAL DISASTER BUT RATHER AS AN INDICATION THAT INDONESIA STILL FACES A VERY UNCERTAIN FUTURE IF ANY ONE OF SEVERAL FAVORABLE DEVELOPMENTS, ON WHICH THE IBRD PROJECTIONS ARE BASED, DOES NOT FALL INTO PLACE. SOME OF THESE DEVELOPMENTS, SUCH AS THE LEVEL OF OIL RESERVES/PRODUCTION AND PRICE/DEMAND FOR EXPORT COMMODITIES, ARE BEYOND THE CONTROL OF GOI AUTHORITIES. HOWEVER, OTHER

VARIABLES, PARTICULARLY WITH RESPECT TO POLICIES DESIGNED TO STIMULATE EXPORT INDUSTRIES AND CURB NON-ESSENTIAL IMPORTS, ARE IN THEIR HANDS. ON BALANCE, WE CONSIDER THE IBRD REPORT TO BE A GOOD ONE AND, PARTICULARLY WITH REGARD TO ITS FAIRLY STRAIGHTFORWARD TREATMENT OF WHAT WE SEE AS AN OVERRIDING NEED TO IMPROVE THE GOI ADMINISTRATIVE APPARATUS, CERTAINLY DESERVES TO BE COMMENDED. IF WE HAVE A FUNDAMENTAL CRITICISM OF THE REPORT IT IS THAT THE BANK, BY ADOPTING A SERIES OF FAVORABLE ASSUMPTIONS RE FUTURE ECONOMIC PERFORMANCE, HAS PRESENTED A PICTURE THAT MAY LEAD THE GOI TO CONCLUSION INDONESIAN FUTURE IS ASSURED. REPORT SEEMS TORN BETWEEN CONFLICTING OBJECTIVES OF, ON THE ONE HAND, REASSURING PROSPECTIVE LENDERS AND INVESTORS THAT INDONESIA REMAINS CREDIT-WORTHY AND, ON THE OTHER HAND, TRYING TO ENERGIZE THE GOI TO TAKE THE MEASURES NEEDED TO MAINTAIN ECONOMIC GROWTH. WE HAVE CONSIDERABLE SYMPATHY FOR BANK'S ATTEMPT TO PRESENT A BALANCED PICTURE, BUT
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AS A RESULT OF PICTURE IT HAS PRESENTED, IT MAY NOT FULLY ACCOMPLISH EITHER OF THESE WORTHY OBJECTIVES. AS WE SEE IT, FUNDAMENTAL TO A RESOLUTION OF INDONESIA'S LONGER TERM GROWTH, PARTICULARLY REGARDING EXPORT PROMOTION AND IMPORT RESTRAINT, IS CONSIDERATION OF A REALIGNMENT OF THE EXCHANGE RATE. THE FORTHCOMING IMF REPORT SHOULD BE HELPFUL IN ASSESSING THIS POINT. WE APPRECIATE THAT GOI, COMING OFF A YEAR OF RECORD EXPORTS WITH LARGE BOP SURPLUS, MAY NOT BE PARTICULARLY RECEPTIVE TO IDEA OF EXCHANGE RATE ADJUSTMENT. WE ALSO RECOGNIZE ADJUSTMENT WITHOUT APPROPRIATE COMPENSATING MEASURES WOULD CREATE INFLATIONARY PRESSURES AND WOULD NOT BY ITSELF ASSURE GROWTH, NEVERTHELESS WE SUGGEST THAT WASHINGTON AGENCIES KEEP THESE FACTS IN MIND IN THEIR OWN ANALYSIS OF INDONESIAN SITUATION.
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